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No. 86-776

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

U S WEST, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA

and

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

This case arises out of the divestiture of the American Telephone and Telegraph Company. Despite the complexity of the AT&T divestiture, this proceeding essentially involves a pure question of law. Petitioner does not seek to undo divestiture, nor to recreate the Bell System. Rather, this petition questions the propriety of injunctive restrictions agreed to by AT&T during the divestiture proceeding, which severely restricted the business activities of its divested subsidiaries after the legal relationship between parent and subsidiary ceased to exist. These restrictions were imposed upon the divested operating companies who were not parties to the lawsuit, who were not parties to the consent decree which terminated that lawsuit, and whose interests were unrepresented in the judicial proceeding culminating in the divestiture decree. The issues for review by this Court are as follows:

1. Whether a sole shareholder of a corporation may bind its subsidiary corporation to a prospective injunction severely restricting its business activities after divestiture, without having assumed any fiduciary responsibility for the interests of said subsidiary.
2. Whether a sole shareholder of a corporation which divests its entire ownership of a non-party subsidiary corporation in a judicial proceeding may bind the operations of the subsidiary after divestiture, when it expressly disclaims any responsibility to represent the interests of the subsidiary, and when the parent was prevented by a patent conflict of interest from properly representing the interests of the subsidiary.
3. Whether the lower court's treatment of these issues is consistent with express pronouncements of this Court concerning the requirements of the Due Process Clause of the Constitution.

PARTIES TO THE PROCEEDING

In addition to the parties listed in the caption, the following parties participated in the proceeding before the United States Court of Appeals for the District of Columbia Circuit: Bell Atlantic Corporation; Pacific Telesis Group; MCI Communications Corporation; Radio Common Carrier Division of Telocator Network of America; Southwestern Bell Corporation; American Information Technologies Corporation; BellSouth Corporation; NYNEX Corporation; and National Association of Regulatory Utility Commissioners.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

U S WEST, Inc. ("U S WEST") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered on August 15, 1986.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A)[1] has been reported sub. nom. *United States v. Western Elec. Co., Inc.* at 797 F.2d 1082 (D.C. Cir. 1986). The decision of the United States District Court for the District

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[1] Citations to "App." refer to appendices to this petition.

of Columbia (App. B) is reported sub. nom. *United States v. Western Elec. Co.* at 627 F. Supp. 1090 (D.D.C. 1986).

JURISDICTION

The judgment of the Court of Appeals was August 15, 1986. The jurisdiction of the Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent constitutional and statutory provisions are set forth in Appendix E and include the Due Process Clause of the United States Constitution, Section 2 of the Sherman Act[2] and Section 16(b)-(h) of the Antitrust Procedures and Penalties Act—commonly known as the "Tunney Act."[3]

STATEMENT[4]

On January 1, 1984, American Telephone and Telegraph Company ("AT&T") divested itself of the stock of its twenty-two operating telephone companies ("BOCs" or "operating companies"), terminating a ten year old antitrust suit brought by the Department of Justice ("Department"). This divestiture, approved by the United States District Court for the District of Columbia,[5] resulted in the transfer of the operating companies' stock to seven newly incorporated holding companies.

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[2] 15 U.S.C. § 2.

[3] 15 U.S.C. § 16(b)-(h).

[4] This Statement is limited to the facts relevant to this petition. It does not attempt to provide a complete description of the litigation surrounding the formulation and enforcement of the consent decree.

[5] *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 222-26 (D.D.C. 1982) (*"MFJ Opinion"*).

Petitioner U S WEST is one of the holding companies, and owns all of the stock of three operating companies.[6]

This petition for certiorari addresses the propriety under the Due Process Clause of allowing AT&T to represent and bind the divested BOCs to a prospective injunction restricting otherwise legitimate business activities, given its patent conflict of interest with the BOCs. This conflict was dramatized by statements of AT&T's counsel during the District Court proceeding which led to entry of the 1982 consent decree:

> the biggest concern of [AT&T] was the consent decree of 1956. We cannot live with that decree. Cannot. The technology of telecommunications has so merged with the technology of data processing that *if we end up with the 1956 consent decree we are a withering corporation waiting for its demise and nothing more.* And I read to Your Honor a letter which we never did put in the record, but would have . . . before the case ended, from a Government lawyer . . . *unless you get out of that consent decree* [*you will be the*] *Penn Central of the '90's, you are dead.* I mean, there is no business, no live, viable business that you can be in. You must get rid of the consent decree.[7]

The restrictions contained in the 1956 consent decree (plus other more burdensome limitations)[8] were subsequently imposed on the divested BOCs as part of AT&T's

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[6] These companies are The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company, which provide telephone services to fourteen western and midwestern states.

[7] *United States v. American Telephone and Telegraph Co.*, 1982-1 Trade Cas. (CCH) ¶ 64,465 at 72,607 (D.D.C. 1982) (emphasis added).

[8] In addition to the 1956 restrictions limiting business activities to common carrier communications services, the new decree, unlike its predecessor, prohibited the BOCs from engaging in manufacturing and the provision of information and interexchange (*e.g.*, long-distance) services.

negotiated settlement of the lawsuit. While AT&T agreed to restrictions insulating it from BOC competition, the resulting settlement left it free to compete with the operating companies.

A. The MFJ Litigation

In 1974 the Department commenced an action against AT&T contending that AT&T was using objectionable means, in violation of Section 2 of the Sherman Act,[9] to thwart competition in the telecommunications equipment and private intercity telephone service markets.[10] The complaint sought the divestiture of Western Electric and Bell Laboratories and, accordingly, the suit named only AT&T, Western Electric and Bell Laboratories as party-defendants. The Department never joined the operating companies as defendants, even after it decided to seek their divestiture rather than Western Electric and Bell Laboratories.

On January 8, 1982, before AT&T had completed its case, the Department and AT&T jointly announced that they were settling the case by entry of a consent decree. The proposed decree lifted the restraints imposed on AT&T by an earlier antitrust consent decree entered in 1956.[11] It required AT&T to divest its operating telephone companies, and proposed that the operating companies be enjoined from any business activity other than those which were defined as "exchange access," "information access" or "exchange telecommunications." Under the proposed decree, AT&T would be free to enter any

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[9] 15 U.S.C. § 2.

[10] *United States v. American Tel. and Tel. Co.*, No. 74-1698, Complaint (D.D.C., filed Nov. 20, 1974).

[11] *See United States v. Western Electric Co., Inc.*, 1956 Trade Cas. (CCH) ¶ 68,246 (D.N.J. 1956). The 1956 consent decree settled an antitrust case brought against AT&T and Western Electric in 1949 relating to alleged monopolization of the telephone equipment market.

business—including exchange telecommunications services directly competitive with the to-be-divested BOCs—while the latter were barred from engaging in any businesses except those limited activities set forth in the proposed decree. The BOCs were to be prohibited from competing with virtually all of AT&T's post-divestiture businesses. The operating companies did not participate in the negotiation of the proposed decree.

After the settlement was announced, the District Court initiated public notice and comment proceedings on the settlement, utilizing the procedures established in the Antitrust Procedures and Penalties Act.[12]

At the inception of the Tunney Act-like proceedings, a number of commenting parties, including the States of California, Michigan, Missouri, and Oregon, argued that some mechanism needed to be established to protect the post-divestiture interests of the non-party operating companies. Observing that the interests of AT&T were diametrically opposed to those of the to-be-divested operating companies, including the proposed injunction against lawful business activities, these parties suggested a variety of means whereby the legal rights of the operating companies might be protected.[13] All such suggestions were vigorously opposed by AT&T and the Department.

In a May 25, 1982 memorandum, the District Court requested comments on the status of the BOCs in the

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[12] 15 U.S.C. § 16(b)-(h). There was a question raised as to whether the Tunney Act applied because the proposed settlement involved a modification of the 1956 decree. AT&T and the Department stipulated to the use of such procedures by the District Court thus rendering the issue moot. *MFJ Opinion*, 552 F. Supp. at 214-17. Therefore, petitioner will refer to the public proceedings held by the District Court as "Tunney Act-like."

[13] For example, it was suggested that the Court could insure proper representation either by divesting the operating telephone companies immediately or by appointing a guardian *ad litem*, or similar officer to represent their interests. *MFJ Opinion*, 552 F. Supp. at 220-22.

proceeding. AT&T filed its response on June 14, 1982, asserting that:

> AT&T and the current BOCs are all segments of a single enterprise owned by a body of shareholders whose interests in Bell System assets AT&T is duty-bound to protect. The Bell System thus speaks with a single voice on the only question presently pending before the Court: whether the Decree is in the public interest. There is no warrant for a separate BOC spokesman on that issue.* [14]

* So long as the BOCs are part of a single enterprise, they cannot by definition have interests divergent from the rest of the enterprise.

AT&T then noted that the BOCs would be entitled to separate representation when they became independent upon divestiture, at which time they would already be "entities bound by the Decree." [15]

These views were repeated by Howard Trienens, Esq., counsel for AT&T, at the Tunney Act-like hearings held on June 29 and 30, 1982. In response to comments by the Assistant Attorney General for the State of Michigan that the BOCs "are going to have their arms and legs cut off," and that it would thus be appropriate for the

[14] AT&T June 14, 1982 Brief in Response at 108.

[15] *Id.* at 109 (footnote omitted). This topic was again addressed by AT&T in a Reply Brief filed June 24, 1982, wherein it reiterated its position on the independent representation issue:

> A number of States also assert that if immediate divestiture of the BOCs is not ordered, separate representation of the BOCs is necessary because of alleged "conflicts of interest" between the BOCs and AT&T. [Footnote omitted.] As noted in AT&T's June 14 Brief (pp. 108-12), the only issue before the Court in this proceeding is whether entry of the Decree is in the public interest. On that issue the Bell System speaks with a single voice. By definition there cannot be a conflict of interest between various parts of the same enterprise.

AT&T June 24, 1982 Reply Brief at 124-25.

BOCs "to have a hand in their own destiny," [16] the following colloquy occurred:

> The Court: We're now talking about a different situation where they are going to be cast adrift and they are going to be, not through any fault of yours, but they are going to be on their own and *they may now—they presumably will 18 months down the road or two years down the road have different interests.*
>
> Mr. Trienens: That's correct.
>
> The Court: And the suggestion that these people are making is if they are going to have different interests shouldn't they have more input than simply being allowed to voice their views at a meeting with AT&T top management, with top management having the final decision-making power? Shouldn't they rather have some independent voice in this? That seems to be the issue and I'm not saying that you are wrong on it. But it doesn't do any good to sweep it under the rug.
>
> Mr. Trienens: We're not going to sweep it under the rug, we're going to face it right up to this idea of spinning them off intact. I want to say in the decision to sign this decree proposal by the Justice Department, the BOC's were again consulted. But again *it was AT&T's decision. If it's approved, they are committed to implementing it,* and the only question is whether the split ordered by the decree is a good idea in the public interest.[17]

On the more specific issue regarding the proposed business restrictions which would be imposed on the BOCs after they became independent entities, AT&T took the

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[16] Transcript of June 29, 1982 Hearing at 25219 ("Tr. at ——").

[17] *Id.* at 25232-25233 (emphasis added). The decree expressly precluded the operating companies from seeking modification of its terms until after divestiture. *Modification of Final Judgment,* Section VII, 552 F. Supp. at 231 ("*MFJ*" or "consent decree") (App. D).

position that it agreed to the line of business restrictions on the operating companies as "part of [its] bargain" with the Department of Justice.[18]

As noted, the Department likewise opposed independent representation for the BOCs, arguing essentially that the "interests of the state regulatory commissions . . . are closely aligned with . . . the divest[ed] BOCs" and therefore they could adequately represent these companies' views.[19] This was contrary to the stated position of the state commissions. In fact, as indicated above, the state commissions were the lead group calling for independent representation on behalf of the operating companies.

On August 11, 1982 the District Court issued its findings regarding the proposed consent decree.[20] AT&T was freed from the restraints contained in the 1956 consent decree while the proposed "line-of-business" restrictions, with several modifications insisted on by the District Court, were imposed on the operating companies.[21] The District Court rejected arguments advanced by a variety of regulatory agencies commenting in the Tunney Act-like proceedings, who had pointed out that the line of business restrictions were unnecessary because they duplicated existing jurisdiction granted by statute to federal and state regulatory authorities.[22] The *MFJ* also required AT&T to submit a Plan of Reorganization providing for the transfer of assets necessary to allow the

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[18] Tr. at 25211.

[19] *Id.* at 25242, 25245 (Statement of Ronald G. Carr, Esq., speaking on behalf of the Department).

[20] *See generally, MFJ Opinion*, 552 F. Supp. 131 (D.D.C. 1982).

[21] For instance, the District Court required that AT&T and the Department agree that the BOCs would be freed from any line of business restriction upon an evidentiary showing that there was "no substantial possibility that [they] could impede . . . competition in the [new] market." *MFJ Opinion*, 552 F. Supp. at 231.

[22] *Id.* at 187, n.229.

BOCs to function independently and the configuration of "exchange areas" which would define the boundaries within which the BOCs could operate.

With regard to the BOC representation issue, the District Court, while recognizing that AT&T had the incentive and ability to advance its own interests at the expense of those of the operating companies,[23] nevertheless concluded that "[*i*]*t is not at all clear* that AT&T will act contrary to the interests of the Operating Companies." [24] The District Court thus rejected the contention that the to-be-divested operating companies should be afforded independent representation, stating:

> Many persons and organizations have questioned the lack of independent representation for the Operating Companies in this proceeding, both prior to the entry of judgment and in conjunction with the preparation of the plan of reorganization. They contend that AT&T's interests under the proposed settlement are diametrically opposed to those of the Operating Companies, and that AT&T therefore cannot be relied upon to act in the Operating Companies' best interests. They suggest that, for these reasons, the Court should ensure the proper representation of the Operating Companies either by divesting them immediately or by appointing a guardian *ad litem* or similar officer to represent their interests. Such participation will not be ordered at this stage of the proceedings, both because it is not necessary, and, more fundamentally, because there is no practical means for effecting it.[25]

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[23] *Id.* at 214, n.345. The Court did, however, specify that, after completion of the Plan of Reorganization, the designated Chief Executive Officers of the Holding Companies would be required to submit statements "certifying that, to the best of their knowledge, the plan will leave the companies which they head as viable entities with the resources necessary to perform the functions described in the decree." *Id.* at 222. These submissions were filed after entry of the *MFJ* and were limited to resource issues (*e.g.*, personnel, equipment, etc.).

[24] *MFJ Opinion*, 552 F. Supp. at 220 (emphasis added) (App. C).

[25] *Id.*

In accordance with the modified decree, AT&T prepared and filed a Plan of Reorganization for court approval. The exchange boundaries and asset transfer proposals were approved by the District Court.[26]

Divestiture was effected on January 1, 1984. On this date, AT&T divested its ownership interest in the Bell System's exchange operations by distributing its stock in the operating companies to seven holding companies, including U S WEST. Shortly thereafter, AT&T commenced a variety of efforts utilizing the consent decree to prevent the operating companies (and their parents) from competing against it.[27]

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[26] *See United States v. Western Elec. Co., Inc.*, 569 F. Supp. 990, 1057 (D.D.C. 1983).

[27] For example, in September of 1984, U S WEST sought a waiver of Section VIII(C) of the MFJ (552 F. Supp. at 231) in order to provide financial services and engage in financing transactions on a nationwide, commercial basis. After the Department of Justice approved U S WEST's entry into the financial services business, AT&T objected to U S WEST's provision of said services to certain telecommunications equipment manufacturers. Ultimately, U S WEST was permitted by the District Court to enter the financial services business (after more than eight months delay), subject to the limitations proposed by AT&T.

In October of 1984, AT&T moved to compel Pacific Northwest Bell ("PNB") to comply with the *MFJ* regarding its private intrastate multi-LATA network connecting offices of the State of Oregon. AT&T alleged, among other things, that PNB was providing inter-LATA services to the State of Oregon in violation of Section II(D)(1) of the *MFJ*. 552 F. Supp. at 227. Additionally, AT&T, as a potential competitor of PNB for the provision of private network switching services, alleged that PNB discriminated against it in the provision of exchange access, in violation of Appendix B of the *MFJ*. 552 F. Supp. at 232-34. The District Court issued a Memorandum Order in June of 1985, rejecting AT&T's allegations.

In February of 1985, AT&T opposed BOC provision of what are commonly known as "shared tenant services" before the lower court in the instant proceeding.

B. Earlier Challenges To The Entrance Of The Decree

During the consent decree proceedings prior to divestiture, the District Court allowed certain parties to intervene for purposes of appealing the resulting *MFJ* and certified their appeals for immediate consideration by the Supreme Court under the Expediting Act.[28] Having been denied independent representation or party status, the operating companies were not able to join in the appeal of the *MFJ*—which was litigated prior to divestiture. In fact, the decere itself prohibited such action until after divestiture, and expressly precluded any independent action by the operating companies until divestiture had been effectuated.[29] Thus, the appeals addressed by this Court did not raise the question of AT&T's authority to bind the post-divestiture operations of the BOCs.

This Court affirmed[30] without opinion over the dissenting opinion of Chief Justice Rehnquist with whom then Chief Justice Burger and Justice White joined. The dissent argued that the case should have been set for oral argument on basically two grounds: (1) whether the District Court exceeded its authority under the Tunney Act in approving the decree based on the mistaken assumption that there had been a judicial finding that the antitrust laws had been violated; and (2) whether the District Court had jurisdiction to approve the settlement.

The first BOC challenge to the entrance of the *MFJ* occurred shortly after divestiture. On July 26, 1984, the District Court issued a decision on a variety of requests for authority to transact businesses not permitted by the *MFJ*.[31] In its ruling, the Court appeared to add four new

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[28] 15 U.S.C. § 29(b).

[29] *See MFJ*, Section VII, 552 F. Supp. at 231.

[30] *Maryland v. United States*, 460 U.S. 1001 (1983).

[31] *United States v. Western Elec. Co., Inc.*, 592 F. Supp. 846 (D.D.C. 1984).

conditions to the consent decree not found in the text itself. U S WEST appealed, asserting, among other things, that AT&T's representation of the operating companies during the consent decree process had been defective. The appeal was subsequently dismissed by the Court of Appeals based on a finding that the District Court order was not ripe for judicial review.[32] All of U S WEST's arguments were preserved by the Court despite the dismissal.[33]

C. The Decision Of The Court Of Appeals Under Review

Subsequently, U S WEST challenged a January 13, 1986 District Court Order which found, among other things, that U S WEST, as the shareholder of three operating companies, was also subject to the *MFJ*'s line of business restrictions.[34] On appeal, the Court of Appeals addressed directly the key issue of AT&T's authority to bind the lawful business operations of the operating companies, their shareholders and affiliates after effectuation of divestiture. The holdings of the lower court were as follows:

1. AT&T was able to lawfully bind the post-divestiture operations of the operating companies by its agreement to the consent decree.
2. U S WEST and other holding company shareholders of divested operating companies, plus other affiliates, were bound by the injunctive provisions of the consent decree.
3. The District Court had erroneously modified the consent decree by imposing geographic limits on the operating companies' provision of exchange telecommunications services.

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[32] *See United States v. Western Elec. Co., Inc.*, 777 F.2d 23 (D.C. Cir. 1985).

[33] *Id.* at 30-31.

[34] *United States v. Western Elec. Co.*, 627 F. Supp. 1090 (D.D.C. 1986) (App. B).

4. U S WEST did not have standing to appeal other aspects of the District Court's order because they involved matters raised by other companies and, thus U S WEST was not bound by those aspects of the decision.

Of these rulings, only the first is the subject of this petition (although the others obviously would be affected if the lower court's decision is reversed). On the issue which is addressed in this petition, the lower court, found, among other things, that:

> U S West's due process argument fails because it ignores the facts that AT&T was a party to the antitrust proceeding and both the RHCs and the BOCs were wholly owned subsidiaries of AT&T at the time the consent decree was entered. . . . Because the RHCs and BOCs were AT&T's privies in the antitrust proceeding, the consent decree is binding on the former AT&T subsidiaries even though they were not parties to the action.[35]

The lower court concluded that the only duty owed by AT&T during the consent decree process ran to its own stockholders. It also found that there was no separate duty running to the soon-to-be-divested companies, despite well-established case law to the contrary. The Court also found that the agreement by AT&T to the imposition of substantial competitive restrictions on the holding companies and BOCs amounted to a "mere[] allocati[on of] Bell System assets and liabilities among different portions of the business in anticipation of divestiture." [36] Thus, it ruled that AT&T's representation of the BOCs—even with regard to post-divestiture activities—would not be invalidated on conflict of interest grounds, even if AT&T's sole motive in agreeing to restrict the BOCs was to free itself.[37]

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[35] *United States v. Western Elec. Co., Inc.*, 797 F.2d 1082, 1087-88 (D.C. Cir. 1986) (App. A).

[36] *Id.* at 1088.

[37] *Id.*

REASONS FOR GRANTING THE WRIT

THE LOWER COURT IGNORED CONTROLLING PRECEDENT OF THIS COURT

In this proceeding, the lower court essentially reversed (or at least ignored) key decisions of this Court which have established fundamental fiduciary and due process requirements which govern whenever one entity undertakes to bind another in a court proceeding. By this Petition, U S WEST challenges the lawfulness of a prospective injunction dramatically limiting its lawful business operations (and the operations of its subsidiaries), which was imposed by a consent decree to which they never consented and which arose out of a lawsuit to which they were not parties. Most importantly, U S WEST challenges the lawfulness of a decree consented to on its behalf by a company which has expressly disavowed any duty to represent their separate interests—the very interests which were bound by the decree. U S WEST does not seek herein to reverse the AT&T divestiture. It seeks only to eliminate certain continuing injunctive restrictions which were unlawfully imposed.

In ruling that U S WEST and its subsidiaries could be bound under the *MFJ*'s injunctive provisions by AT&T's consent, the lower court expressly found that AT&T owed no duty to represent the interests of U S WEST and its subsidiaries when it undertook to bind their future operations. In fact, the lower court expressly found that "[e]ven if U S West is correct in asserting that AT&T agreed to restrictions on the RHCs and BOCs in order to free itself of restrictions," [38] such a conflict of interest was "irrelevant" to analysis of whether due process required representation of the BOCs' interests during the *MFJ* proceeding. Thus, the lower

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[38] *Id.*

court found that even self-dealing by AT&T would not invalidate its authority to represent and bind the BOCs.

In contrast, this Court has consistently held that an entity cannot be bound to the provisions of a consent decree in the absence of actual consent or proper representation.[39] This essential proposition derives from the basic notion that a consent decree is a contract enforceable as a judicial decree.[40] Neither the operating companies, nor any representative thereof, agreed to any provision of the consent decree. In fact, their participation in the *MFJ* proceeding was precluded by the District Court.

Based on due process considerations, this Court has also repeatedly recognized that an entity cannot be bound to a judicial decree (consent or litigated) unless its interests in the subject matter of the proceeding were adequately represented—especially when the bound entity was not a party to the litigation. It is a corollary to this principle that one who undertakes to represent the rights of another in a judicial proceeding assumes the role of a fiduciary, and thereby owes a greater duty to the entity whose interests are represented. These precepts are rooted in traditional notions of due process and form the predicate for valid class action suits,[41] proceedings involving associational representation,[42] and the concept of legal privity.[43]

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[39] *United States v. Ward Baking Co.*, 376 U.S. 327, 334 (1964).

[40] *United States v. Armour & Co.*, 402 U.S. 673, 681 (1971).

[41] *Hansberry v. Lee*, 311 U.S. 32, 42-45 (1940).

[42] *Sam Fox Publishing Company v. United States*, 366 U.S. 683, 691-93 (1961).

[43] *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 110 (1969).

In this case, the lower court created an exception to these uniformly accepted principles which finds no support in American jurisprudence and is inconsistent with controlling decisions of this Court. The lower court essentially suspended the standard representation and fiduciary rules which ordinarily apply to all contracts and lawsuits (divestiture-related or otherwise) based solely on the fact that AT&T owned the stock of its soon-to-be-divested BOC subsidiaries during the consent decree proceedings. Paradoxically, the lower court recognized that these same rules would be in full force where divestiture of a recently acquired company is sought. The lower court also ruled that a corporate ownership relationship overrode the essential "community of interest" requirements which underpin the law of privity. In so finding, the lower court not only ignored the reality of the transaction under review but, more significantly, ignored controlling decisions of this Court which precluded the very exceptions postulated.

A. The Lower Court Effectively Overruled Fundamental Principles Of Fiduciary Law Enunciated By This Court

In the case at bar, it has been conceded that AT&T negotiated the consent decree and, in its capacity as sole shareholder of the subsidiary BOCs, agreed that these companies would be prohibited from engaging in otherwise lawful business operations *after* divestiture.[44] It is also undisputed that the operating companies were never made parties to the suit,[45] and that AT&T vigor-

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[44] AT&T Brief at 17-26.

[45] In fact, the divestiture lawsuit originally proposed restrictions on two AT&T subsidiaries—Western Electric Company, Inc. and Bell Telephone Laboratories and separately named these companies as parties to the lawsuit. For purposes of this appeal, however, AT&T is the sole relevant defendant. The naming of the two subsidiaries mentioned above as parties, while not so naming (or serving process upon) the operating companies does, however,

ously opposed all efforts to permit these operating companies to represent their own post-divestiture interests (or to obtain some other vehicle for fair representation not dominated by AT&T's own interests).[46]

In its initial brief to the lower court, U S WEST pointed out that the *MFJ* record and AT&T's own actions after divestiture demonstrated that AT&T had negotiated the *MFJ*'s injunctive provisions in a manner which advanced its own corporate interests at the expense of those of the BOCs. Indeed, AT&T had imposed line of business restrictions injurious to the BOCs in a manner which served AT&T's own post-divestiture interests and which protected AT&T from future competition by the operating companies. Under these circumstances, U S WEST argued that well-established principles of fiduciary law should have disqualified AT&T from serving as the BOC's representative in the consent decree process. Moreover, U S WEST postulated that the consent and participation requirements essential to enforcement of the line of business restrictions against the BOCs (after divestiture) were not fulfilled.[47]

In responding to U S WEST's initial brief, AT&T and the Department did not even attempt to argue that AT&T had properly fulfilled the fiduciary role which the law imposes on one who undertakes to bargain on behalf of another. To the contrary, AT&T and the Department contended that AT&T had no duty to represent the soon-to-be-divested operating companies because of AT&T's pre-divestiture stock ownership. For example, AT&T asserted:

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underscore an important omission by the Department of Justice in establishing *in personam* jurisdiction and party status with regard to the BOCs.

[46] *See* p. 5, n.13; 9, *supra*.

[47] See U S WEST Brief at 27-39.

> U S West's citations . . . that discuss the obligations of a fiduciary are beside the point . . .[48]. AT&T had no fiduciary obligations to the management of any one part of the unitary Bell System.[49]

Thus, AT&T and the Department argued that AT&T had no fiduciary duty in binding the BOCs to post-divestiture restrictions.

The lower court agreed with this basic proposition, and found that even self-dealing by AT&T would not have invalidated its representation of all parts of the Bell System during the consent decree proceeding:

> . . . [T]he only duty owed by AT&T was to its shareholders, who were identical to the initial RHC shareholders. *Even if U S West is correct in asserting that AT&T agreed to restrictions on the RHCs and BOCs in order to free itself of restrictions, there was nevertheless no injury* to the shareholders.[50]

Thus, the sole fact that AT&T owned the stock of the operating companies prior to divestiture was held to have two important consequences:

1. AT&T had, by virtue of such ownership, absolute dominion over and discretion to control (through agreement to consent decree restrictions) the post-divestiture operations of the operating companies.

2. AT&T was relieved of the duty to adhere to standard fiduciary principles in representing the

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[48] AT&T Brief at 22, n.**

[49] *Id.* at 22. See also Department of Justice Brief at 31-32. ("[I]n terms of fiduciary duty, there was only one duty owed: AT&T's duty to its shareholders.")

[50] 797 F.2d at 1088 (emphasis added). The lower court's assertion that AT&T's shareholders were identical to the initial Holding Company shareholders is incorrect. U S WEST's stock commenced public trading in November of 1983, prior to divestiture.

> severable interests of its to-be-divested operating company subsidiaries.

Such a result is inconsistent with decisions of this Court and basic notions of due process.

This Court has held that exercise of control over a subsidiary corporation by a stockholder creates, rather than eliminates, a fiduciary relationship. It has also expressly rejected the notion that a controlling shareholder may utilize such ownership as a shield to avoid the standard of fair dealing and representation which the law imposes upon one who acts on another's behalf. Thus, a controlling stockholder is normally held to an exacting standard of a fiduciary by virtue of the exercise of such control alone. In contrast with the lower court's finding, exercise of such control actually triggers a higher degree of fiduciary responsibilities.

These precepts were set forth in the landmark decision of *Pepper v. Litton*[51] in which this Court described the following "cardinal principles of equity jurisprudence":

> A director is a fiduciary. So is a dominant or controlling stockholder or group of stockholders. Their powers are powers in trust. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside. . . . [T]hat standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation . . . .[52] (Footnotes and cited case law omitted.)

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[51] 308 U.S. 295, 306 (1939).

[52] *Id.* at 306-7.

Thus, the proposition that a stockholder acts as a fiduciary *vis-a-vis* a controlled corporation is well-established.[53] Fiduciary duties are also recognized whenever a relationship results in one entity controlling and acting in the name of another.[54] This is particularly the case in court proceedings where the duty to avoid representation of conflicting interests is to be strictly observed.[55]

In this case, AT&T originally undertook to represent the post-divestiture interests of the operating companies before the District Court, entered into a consent decree severely restricting those same interests, and vigorously opposed suggestions that the operating companies should be afforded some mechanism to protect their post-divestiture rights. Under these circumstances, standard equitable principles required the appointment of a separate representative—or at the very least, recognition by AT&T that it owed a separate fiduciary duty to its soon-to-be-divested BOC subsidiaries.[56]

Thus, the lower court turned this Court's analysis in *Pepper v. Litton* on its head—finding that the very rela-

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[53] *Superintendent of Ins. of St. of N.Y. v. Bankers L. & C. Co.*, 404 U.S. 6, 12 (1971); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 522 (1941); *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919).

[54] *Felix v. Patrick*, 145 U.S. 317, 321 (1892).

[55] See, e.g., *Wood v. Georgia*, 450 U.S. 261, 271 (1981) ("there is a . . . right to representation that is free from conflicts of interest").

[56] *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329-330 (1981) ("To deter the trustee from all temptation and to prevent any possible injury to the beneficiary, the rule against a trustee dividing his loyalties must be enforced with 'uncompromising rigidity.' . . . A fiduciary *cannot* contend 'that, although he had conflicting interests, he served his masters equally well or that his primary loyalty was not weakened by the pull of his secondary one.' ") (emphasis added).

tionship which normally imposes a fiduciary obligation on a parent corporation actually provided AT&T with an excuse not to represent the clearly separate interests of its BOCs. Because AT&T's express denial of any responsibility to represent the post-divestiture interests of the operating companies left those interests unrepresented, due process precluded application of the consent decree's injunctive provisions to these entities.[57]

B. The Lower Court Enunciated A New Standard Of "Privity" Inconsistent With Traditional Notions Of Due Process

The lower court's finding that the BOCs were lawfully bound by the *MFJ*'s post-divestiture restrictions on the basis of "privity" with AT&T similarly misconstrues the nature of the law of privity and its relationship with fundamental due process. The lower court ruled that the essential principles recognized by this Court in *Sam Fox Publishing Company v. United States*[58] and *Hansberry v. Lee*[59] were not applicable to AT&T or the operating companies because privity existed among these entities, due solely to the pre-divestiture wholly-owned subsidiary relationship.[60] Thus, the lower court found "no authority . . . for [U S WEST's] remarkable proposition that a parent may not bind its wholly owned subsidiaries

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[57] The lower court ruled that even if "AT&T [had] breached [a fiduciary duty to the operating companies], this would at most demonstrate that the RHCs have a cause of action against AT&T. It would not follow that the RHCs are entitled to judicial relief from the obligations of the consent decree." 797 F.2d at 1088. This assertion misapprehends U S WEST's position. The lower court did not find that AT&T endeavored to represent the post-divestiture interests of the operating companies, but did so poorly. Rather, the lower court found that AT&T had no duty to represent these interests at all.

[58] 366 U.S. 683.

[59] 311 U.S. 32.

[60] 797 F.2d at 1087-88.

without affording them independent legal representation," and ruled that: "[i]t is self-evident that due process does not require such representation." [61] The lower court thus found that AT&T could bind the BOCs to the injunctive provisions of the *MFJ* because they were in privity, yet held that this privity relationship did not include the duty to represent the separate post-divestiture interests of the BOCs. This ruling of the lower court misconstrues both the law of privity and U S WEST's position on its applicability to this proceeding.

The concept of legal privity, for purposes of enforcing a judgment, is predicated on the due process concept that a "non-party may be bound by a judgment if one of the parties to the earlier suit is so closely aligned with the non-party's interests as to be its virtual representative." [62] It is well-established that "the sound general rule is that the stockholder-corporation relationship does not of itself establish privity." [63] These concepts are rooted in the bedrock proposition that a non-party must be adequately represented by a privy before it can be bound by a judgment.[64]

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[61] *Id.* at 1088.

[62] *Mothers Restaurant, Inc. v. Mama's Pizza, Inc.*, 723 F.2d 1566, 1572 (Fed. Cir. 1983), *citing Chicago, R. I. & P. Ry. Co. v. Schendel*, 270 U.S. 611, 618, 46 S. Ct. 420, 423, 70 L. Ed. 757 (1926); *Heckman v. United States*, 224 U.S. 413, 445-46, 32 S. Ct. 424, 434-35, 56 L. Ed. 820 (1912). *See also Aldrich v. Aldrich*, 378 U.S. 540, 543 (1964) (*per curiam*).

[63] *See* 1B J. Moore, J. Lucas & T. Currier Moore's Federal Practice, ¶ 0.411[10] at 478 (2d ed. 1984).

[64] This essential principle was emphasized in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, (1969), where a lower court had entered a judgment against a stockholder owning 100 percent of a defendant corporation on the basis of a stipulation by the subsidiary that the parent and subsidiary would be considered "one and the same corporation" for purposes of the lawsuit. Relying on such prior decisions as *Hansberry v. Lee, supra*, and *Pennoyer v. Neff*, 95 U.S. 714 (1878), this Court reaffirmed the

The lower court's ruling that AT&T's ownership of the stock of the operating companies prior to divestiture established legal privity for all purposes is erroneous. Its finding that privity to represent and bind the BOCs would not be destroyed, even if the interests of AT&T and the BOCs diverged, conflicts directly with this Court's ruling in *Sam Fox*, *Hansberry* and their progeny.[65]

The consequences of the lower court's misinterpretation of the law of privity is highlighted by the fact that the injunctive provisions at issue here did not take effect until after the legal relationship between AT&T and the operating companies had ceased to exist. Thus, the lower court's characterization of the issue—whether "a parent may . . . bind its wholly owned subsidiaries without affording them independent legal representation" [66]—was far too broadly framed since this case actually involved a parent attempting to restrict severely the activities of its subsidiaries *after* they ceased to be its subsidiaries.

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importance of representation before a judicial tribunal in order for a judgment to be enforced:

> Although injunctions issued by federal courts bind not only the parties defendant in a suit, but also those persons "in active concert or participation with them who receive actual notice of the order by personal service or otherwise," . . . a non-party with notice cannot be held in contempt until shown to be in concert or participation. It was error to enter the injunction against Hazeltine, without having made this determination in a proceeding to which Hazeltine was a party. 395 U.S. at 112.

[65] The lower court also cites this Court's decision in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) (in another context) for the proposition that "under the antitrust laws, corporations and their wholly owned subsidiaries function as a single enterprise." 797 F.2d at 1088. *Copperweld*, however, dealt with only a single "narrow issue squarely presented: whether a parent and its wholly owned subsidiary are capable of conspiring in violation of § 1 of the Sherman Act." 467 U.S. at 767. This Court's negative answer to the above question does not give credence to the proposition advanced by the lower court.

[66] 797 F.2d at 1088.

Lawful privity was established by AT&T, as shareholder of the operating companies, to agree to dispose of its subsidiaries' stock or assets—by way of sale, spin-off or otherwise. Petitioner is thus not arguing here that the divestiture itself was unlawful or should be reversed. AT&T likewise had the ability to commit itself to those injunctive provisions of the decree which apply to it—such as a seven year prohibition against entering the electronic publishing business. The *MFJ*, however, purports to bind the operating companies to a prospective, prohibitive injunction which precludes them from conducting lawful business after any conceivable privity between AT&T and the operating companies had been dissolved. AT&T's attempt to insulate itself from competition by limiting the activities of the operating companies after divestiture, without affording them an opportunity to be heard, thus falls well beyond its shareholder power and violates the concept of legal privity.

In summary, the lower court's ruling that privity may be established and maintained in a manner inconsistent with the basic due process rights of entities not parties to a lawsuit is contrary to key decisions of this Court. For purposes of binding the post-divestiture business operations of the operating companies, AT&T and the operating companies were not in privity—and could not have been in privity unless AT&T had adequately represented the post-divestiture interests of the operating companies.

C. The Lower Court's Ruling Is Inconsistent With Other Relevant Decisions Of This Court

The decision under review also ignores this Court's decision in *Cascade Nat. Gas Corp. v. El Paso Nat. Gas Co.*[67] in which a consent decree was remanded for hearing, at least in part, based on the following finding by this Court:

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[67] 386 U.S. 129, 137-38 (1967).

> As already indicated, the proposed decree provides the terms of contracts imposed on the New Company [to be formed by El Paso upon divestiture] respecting the purchase and gathering of gas from various sources. It is urged that these contracts are onerous, detrimental to the New Company, and partial to El Paso interests. We do not pass upon the wisdom or desirability of the proposed contracts. It is enough to note that they were proposed by El Paso, that the changes reluctantly acceded to by the government, will redound to the substantial benefit of El Paso, and that *the New Company has had no opportunity to evaluate the advisability of the terms or to negotiate for better terms.* Nor has the Federal Power Commission had the opportunity to pass upon the contracts. *The terms of these contracts should be negotiated by the New Company* under such restrictions as the Natural Gas Act may impose. (Footnote omitted and emphasis added.)

Consistent with *Cascade*, the lower court here agreed that a company acquired by another was "entitled" to independent legal representation during litigation aimed at divestiture. In fact, the lower court recognized this principle of law under its own established precedent—*F.T.C. v. Exxon Corp.*[68]—a case involving the proper application of traditional notions of due process. Inconsistent with *Cascade*, however, the lower court found that the distinguishing factor in *Exxon* was that it involved a Federal Trade Commission ("FTC") suit challenging the acquisition of a separate company ("the Drives Group"), and therefore, unlike the instant situation, involved two definable entities which could be represented separately.[69] The lower Court's acquisition-based

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[68] 636 F.2d 1336 (D.C. Cir. 1980).

[69] In contrast to the Court of Appeals assumption that Exxon and the Drives Group could be neatly separated, the Court in *Exxon* actually stated that the "Drives Group is now subsumed by Exxon." 636 F.2d at 1346.

theory results in a completely illogical application of due process rights.

The decision under review essentially finds that where divestiture is contemplated, due process analysis requires an initial determination of when the defendant purchased the subsidiary corporation sought to be divested. If the subsidiary was recently purchased, traditional due process protections and adequate representation apply. If the subsidiary had been owned for a more lengthy period of time, its interests receive no protection at all. Thus, there is no logical basis upon which to draw such a distinction—a fact underscored by this Court's decision in *Cascade*, wherein the entity which was granted separate representation status was an entirely new corporation.

In addition, the interests considered in *Exxon* which led to the finding that the appointment of a separate representative for the acquired subsidiary was essential are indistinguishable from the instant situation. In contrast to the lower court ruling here, the *Exxon* Court found that although Exxon and the acquired Drives Group shared a "corporate identity" and a common interest in obtaining final approval of the acquisition in the face of an FTC divestiture lawsuit, "that identity might be shattered as a result of the challenge mounted by the FTC . . . ." [70] Consistent with traditional notions of due process, the Court recognized that "[t]his possibility . . . gives rise to a fundamental conflict" [71] and joint representation therefore would be improper. Directly contrary to the decision under review, the Court recognized:

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[70] *Id.* at 1345.

[71] *Id.*

> [I]t is not the Drives Group as part of Exxon that Exxon may not represent; it is the Drives Group as *potentially* separate from Exxon that Exxon is prohibited from representing.[72]

Thus, it is virtually impossible to distinguish *Exxon* unless artificial distinctions are deemed to control basic representational rights derived from the Due Process Clause. Although the *Exxon* decision is not a case decided by this Court, petitioner submits it is a worthy example of the proper application of the legal principles reviewed herein and commend it to the Court's attention.

CONCLUSION

The decision below essentially creates a sweeping exception to the due process-based notion that a non-party to a lawsuit cannot be bound by a judgment unless its interests were adequately represented—or at least it had a fair opportunity to be represented. The decision below also repudiates the rule of law established by this Court that a corporate stockholder owes a fiduciary duty to a subsidiary whenever the stockholder attempts to exercise dominion and control over the operations of the subsidiary.

Both of the above rulings underpin the continued applicability of the *MFJ*'s prospective line of business restrictions to U S WEST and its subsidiaries and are contrary to well-established decisions of this Court. These fundamental legal errors are of significance far beyond their specific impact on U S WEST. If left intact, they could dramatically alter the essential representational rights guaranteed by the Due Process Clause of the United States Constitution.

Petitioner therefore respectfully requests that this Petition for a Writ of Certiorari to the United States Court

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[72] *Id.* at 1346-47. (Emphasis added.)

of Appeals for the District of Columbia Circuit be granted.

Respectfully submitted,

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